InvesTips

Equity market volatility

From chaos to clarity

October 2025

It's no secret that equity markets are prone to volatility. This often stems from shifts in policies, geopolitical and economic landscape, or regulations. Typically, extreme market volatilities trigger panic and over-reaction among investors at a time when the best strategy is to stay calm and assess risks and opportunities.

Understanding the drivers of volatility, assessing investor sentiment based on market cycles and pursuing a structured approach can help one tide over such periods. Staying the course could even result in outsized returns.

In this publication, we identify approaches to help manage market risk to best protect (and even grow) your investments.

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Understanding the risks

Equity assets typically entail two types of risks: systematic and unsystematic.

Unsystematic, or idiosyncratic risk, stems from company- or sector-specific concerns and are easily diversifiable. Fluctuations in the stock price of a company due to its earnings performance is an example of unsystematic risk.

Systematic risks affect the entire market or segment and, therefore, is much harder to diversify. For instance, uncertainties caused by the tariff policies in President Trump's second term spooked most equity markets and are a good example of systematic risk. Blunting the unfavourable impact of systematic risks requires strategic asset allocation across asset class.

Understanding the difference between the two types of risks can help investors identify and manage them successfully.

Fig. 1
Systematic vs unsystematic risks

	Systematic risks	Unsystematic risks
Nature	Can't be controlled, minimised or avoided by a business's management	Can be controlled, minimised or even avoided by a business's management
Impact	Large number of securities associated with the entire market or segment	Restricted to a specific industry, segment, company or security
Factors	External or macroeconomic factors, including geopolitical, economic and sociological	Internal or microeconomic factors
Protection	Asset allocation	Investment portfolio diversification
Avoidability	Can't be avoided	Can be avoided and resolved

Source: Standard Chartered

Common factors behind unsystematic risk

- **Performance risk or financial risk** stems from a company's overall operating performance. Indebtedness, liquidity and competitive landscape all play a role in ascertaining this risk.

- **Operational risk** arises due to transaction/execution errors, fraud or technical failures. For instance, technical failures in a US company's power business and accounting issues in its insurance business in 2018 led to a sharp 75% fall in its stock price.

Systematic factors

- **Macroeconomic markers** such as GDP, inflation, unemployment and policy rates can have a significant impact across financial markets. For instance, US inflation peaked around 9% in June 2022 and, amid higher interest rates and a slowing economy, the S&P 500 suffered an approximately 8% drop over the month.

- **Policy changes**, such as tariff revisions and fiscal and monetary adjustments, can also influence the broader markets. Such changes are usually country-specific and therefore drive share prices mostly in that country. However, significant policy changes in large economies, such as US tariff revisions, can have a global market impact.

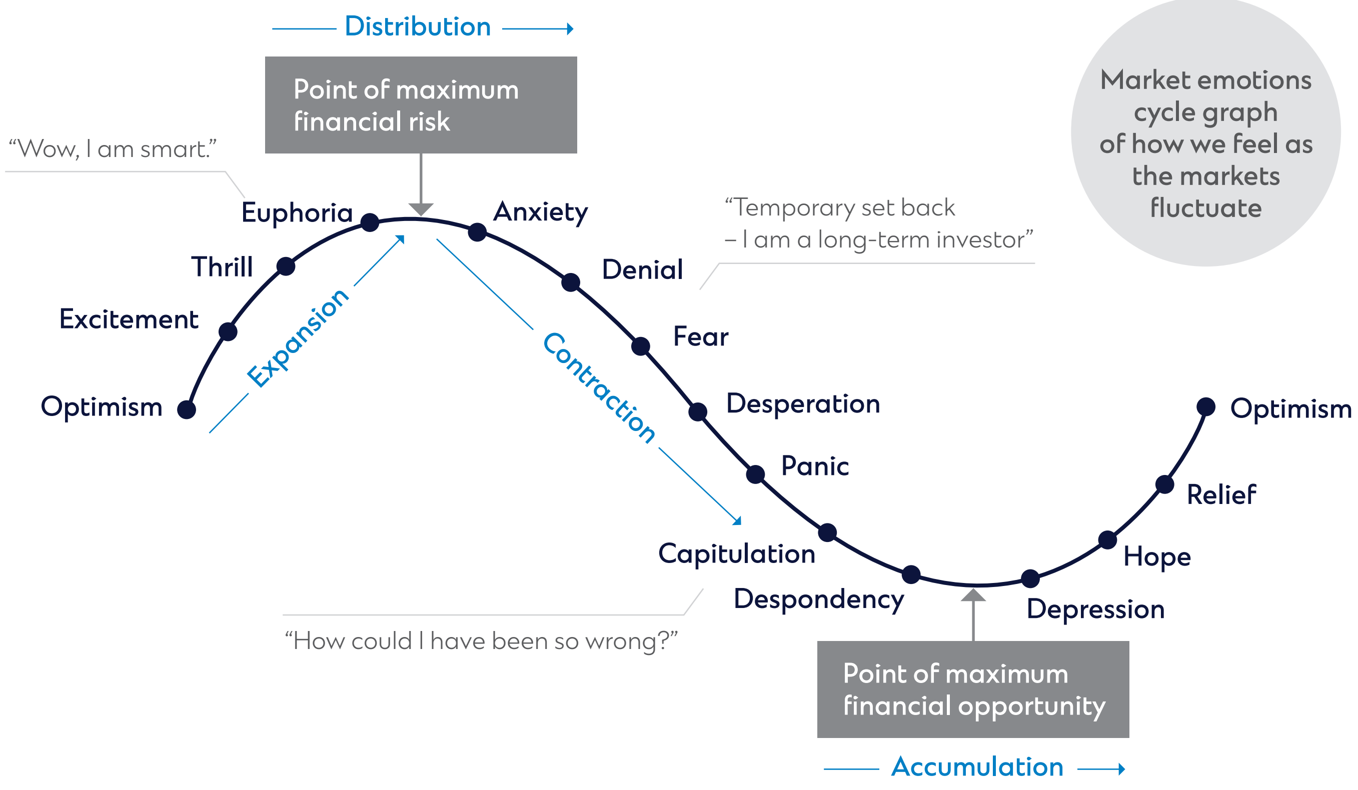
- **Geopolitical factors**, such as elections, diplomatic tensions, wars and sanctions, can also result in large swings in business and investor confidence. Geopolitical conflicts, for example, often lead to sharp sell-offs in equity markets as investors flee to safe-haven assets such as gold and US government bonds. Some sectors, such as energy, defence and technology, are often more vulnerable to these geopolitical risks than others.

Identifying the market cycle

Investor sentiment and volatility in equity markets are not just governed by risks but also oscillations in the market cycle.

The graphic below illustrates a common cycle in markets and sentiment. In this framework, markets go through four distinct phases, each characterised by a specific type of investor sentiment. The ability to identify these phases will not only help one keep their emotions in check but may also lead to identifying opportunities that can result in market-beating returns.

Fig. 2
Market cycle and investor sentiment



Source: Standard Chartered, The Tokenist Media

Expansion phase

This phase is characterised by a shift in investor sentiment from neutral to bullish, and economic indicators and earnings start showing a gradual uptick. With rising positive sentiment, the uptrend gains momentum and investors interested in growth stocks find opportunities. At the initiation of this phase, value stocks tend to outperform, followed by growth, momentum and cyclical stocks. There may be several mini cycles within this phase and a higher peak may be achieved with each subsequent cycle. A buy-the-dip strategy is usually pursued by investors managing active portfolios. Given the robust economic activity and increased discretionary spending, sectors such as financial services and consumer discretionary sub-sectors like consumer electronics, automobile and entertainment tend to perform well.

Distribution phase

During this phase, valuations tend to heat up and market participants are generally divided into two distinct groups. One group remains optimistic of a continued uptrend, but the other starts to turn pessimistic. Economic cues and corporate earnings are mixed. Market volatility is high during this phase. Value investors tend to exit their holdings in a phased manner. In this phase, 'buy-the-dip' strategy may not work as prominent indices stop scaling new peaks. Consumer discretionary, utilities and healthcare usually continue to perform well during this phase.

Contraction phase

This is when markets start to tumble and the sentiment turns bearish. Continued weak economic cues or poor corporate earnings mark the beginning of this phase. Anxiety and panic are dominant sentiments among investors, often leading to sizeable market sell-offs. Fearing a further dip in portfolio values, many investors tend to pull out their investments. Margin traders may be forced to liquidate their holdings to meet margin calls. Speculative and overvalued stocks tend to fall sharply, while defensive plays such as consumer staples and healthcare may experience milder weakness. Such sell-offs tend to be triggered by panic and, thus, prices of all stocks tend to fall independent of fundamentals.

Accumulation phase

This phase follows the mark-down phase and market trough. There may be multiple lower-lows during this phase and one cannot be certain if a specific trough indeed marks the end of the contraction phase. Panic and anxiety start to settle at the onset of this phase. Institutional investors gain a foothold and start investing, leading to better market cues. Market volatility is rangebound and overall sentiment remains neutral. This is when contrarian and value investors start bargain hunting for quality investments and slowly outnumber the pessimists, paving the way for a return to yet another expansion phase.

Themes to insulate a portfolio

It is important to understand how sectors generally perform during different market phases to diversify meaningfully and insulate a portfolio from major market downturns.

Cyclical sectors

These sectors tend to outperform during expansionary (bullish) phase and decline during mark-down periods and bear high correlation to the wider business cycle.
Basic materials manufacturers (chemicals, building materials and paper products), retail discretionary, automobile and financial services are considered cyclical sectors.

Neutral sectors

These sectors have a moderate (neutral) correlation with business cycles. While they tend to perform reasonably well during the expansionary phase, they may suffer more moderately during market downturns. Some of the sectors that fall within this category are telecommunication, energy and technology.

Defensive sectors

Companies where production and consumption remain mostly consistent irrespective of the prevalent market phase are considered defensive. Consumer essentials, healthcare and utilities fall under this category. These sectors can offer some insulation to portfolios during extreme market dips.

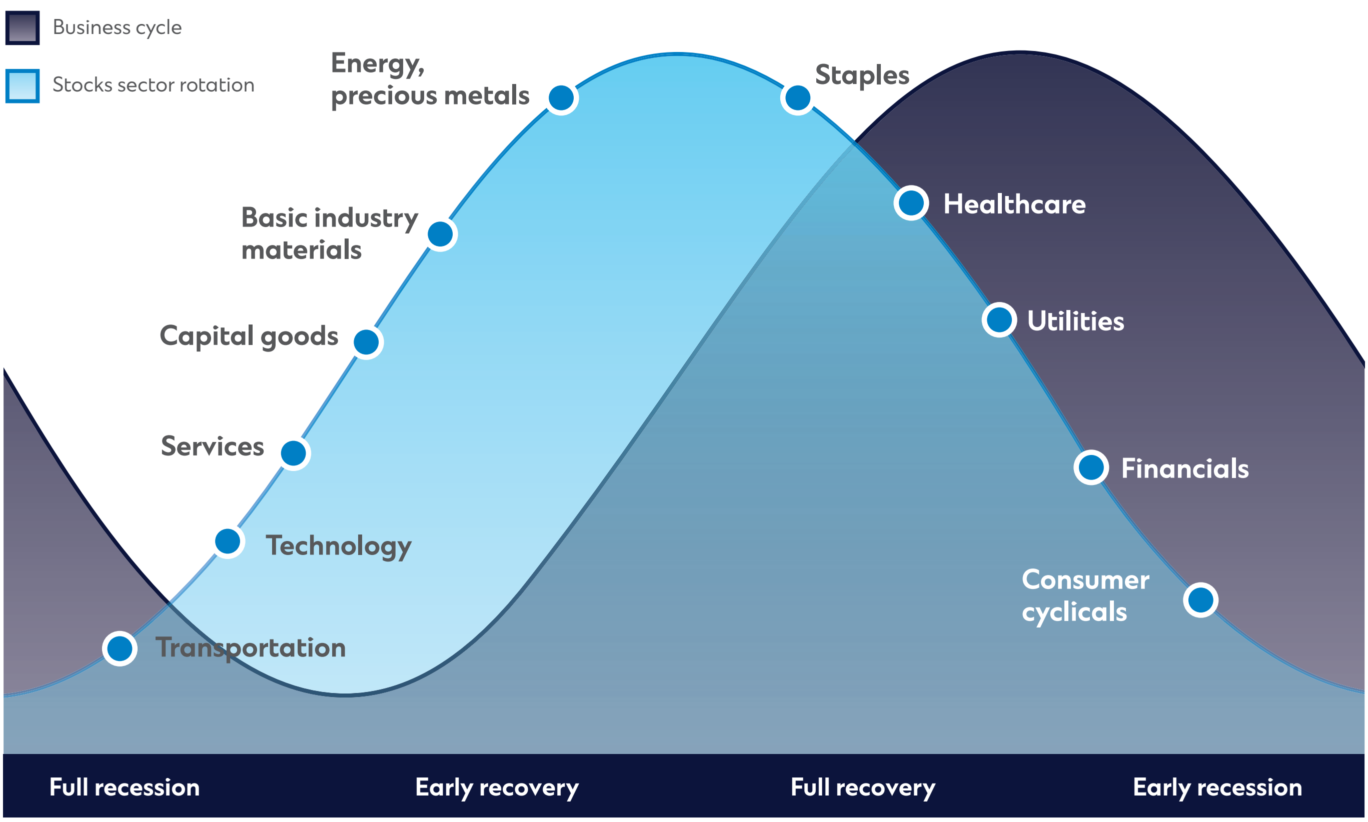
Investors seeking profits across market cycles can use a sector rotation strategy, by pivoting in and out of sectors coinciding with the movements in the economic cycle. This strategy aims to generate higher-than-average returns across all market phases. A top-down approach, as discussed below, is usually employed to successfully implement this strategy.

- **Ascertaining the economic phase:** A thorough analysis of economic parameters such as GDP, inflation and monetary policy can offer a good understanding of the current phase of the economic/market cycle. For instance, an uptick in GDP, rising inflation and low policy rates together may signal the expansion phase of the cycle.
- **Identifying sectors with potential:** Having identified the phase, investors should now shortlist sectors that are likely to perform well during a particular phase. Although every market cycle is unique and may not mirror the past, certain sectors have historically performed well during specific market phases, e.g. consumer discretionary during the expansion phase and utilities during a contraction phase.
- **Consistent review and monitoring:** After investing in sectors that you believe are well positioned to outperform the broader market, it is critical to monitor and review the performance. If there is any deviation from the desired outcome, there may be a need to reassess the chosen sectors or companies as the broad-brush trends can differ slightly across business cycles.

While implementing this strategy, the investor should be mindful of sector-specific risks such as regulatory changes, consumer behavioural shifts and supply chain disruptions. An investor intending to implement a sector rotation strategy can use several indicators of the market cycle, such as the S&P500 volatility index (VIX), as markers to assess the movement in market phases to determine when to pivot in and out of cyclical or defensive sectors.

Fig. 3

Sector rotation: Stocks sector rotation vs business cycle



Source: Standard Chartered

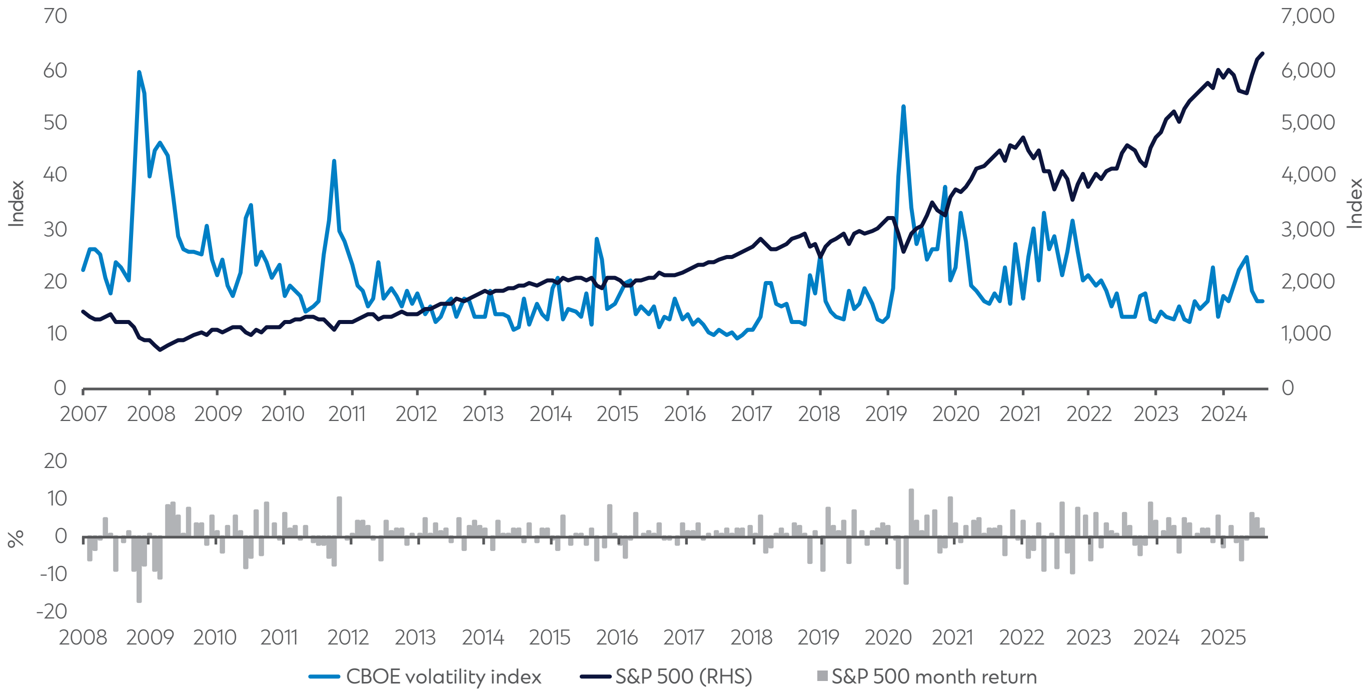
VIX – a deep dive into the S&P 500 volatility indicator

The Volatility Index (VIX), also called the fear index, is a real-time measure of price fluctuations of S&P 500 index options. This offers an assessment of the market's expectations for volatility in the S&P 500 over the next 30 days.

The VIX shares an inverse relationship with the S&P 500 and has in the past flagged prevalent negative sentiment in the market accurately. On its own, it is a lagging indicator and thus may not be capable of reliably predicting future declines. However, it can be used in conjunction with other indicators to aid in devising sector strategies that can help navigate market upheavals.

- **Financial crisis 2008-2009:** VIX peaked at around 60 in October 2008, indicating extreme fear, when the markets crashed on the backdrop of the collapse of Lehman Brothers.
- **2012 rally:** The Fed's third round of quantitative easing triggered a strong equity market rally. The VIX dipped sharply to indicate the euphoric sentiment in markets. The VIX oscillated between 10-20 points for almost a year.
- **2020 pandemic:** In March 2020, the VIX briefly traded above 60, indicating increasing fear against the backdrop of the pandemic. In November 2020, amid speculation surrounding a possible vaccine, the fear index value fell to 20.

Fig. 4
VIX-S&P 500 correlation



Source: Standard Chartered

Research indicates that cyclical sectors such as industrials, chemicals and manufacturing materials tend to outperform after VIX spikes. This is because after market sell-offs, stocks in cyclical sectors become oversold and trade at a discount, presenting buy-low opportunities, while defensives are already overbought.

A study published by the National Association of Active Investment Managers (NAAIM) observed the efficacy of using VIX in conjunction with a sector rotation strategy (implemented via ETFs) to generate alpha. The study, spanning 20 years (1998-2018), concluded that a VIX-based sector rotation strategy consistently outperformed a passive investing strategy, delivering optimised risk-adjusted returns. Rotating in and out of specific sectors after VIX spikes or troughs helped in exploiting the mean reverting trend across methods. The table below shows the performance of cyclical and defensive sectors over the 200 trading days following various VIX levels. This illustrates how sector returns differ based on market volatility and how strategic shifts in sector allocations can optimise returns.

Fig. 5

Sector 200-trading day forward returns by rolling 14-day VIX (1998 – current)

VIX Range	Industrials	Consumer Staples	Financials	Consumer Discretionary	Materials	Energy	Healthcare	Technology	Utilities
10 – 12	10.56%	5.21%	7.35%	9.36%	11.17%	11.28%	8.57%	14.04%	8.25%
12 – 14	8.83%	7.31%	6.73%	7.22%	7.53%	5.51%	8.65%	9.96%	9.95%
14 – 16	11.10%	8.68%	10.03%	9.26%	9.79%	10.39%	10.32%	10.52%	14.00%
16 – 18	9.46%	8.65%	5.77%	10.49%	8.23%	12.23%	8.78%	6.06%	12.69%
18 – 20	1.38%	4.36%	-1.21%	4.21%	2.52%	3.14%	3.11%	-1.77%	4.31%
20 – 25	-0.61%	1.91%	-2.44%	0.39%	-1.73%	2.15%	0.73%	-4.89%	-0.56%
25 – 30	4.13%	2.14%	-0.47%	7.37%	4.51%	3.31%	1.93%	2.74%	0.93%
30 – 35	16.18%	8.33%	15.91%	20.83%	17.96%	9.66%	14.38%	15.72%	8.91%
35 – 40	13.04%	6.55%	15.68%	17.82%	12.86%	8.99%	14.71%	21.09%	11.81%
40 – 45	36.60%	22.09%	52.14%	42.80%	43.40%	26.54%	22.69%	40.52%	13.72%
45 – 50	47.76%	25.60%	69.23%	55.90%	56.47%	30.72%	24.67%	50.48%	19.10%

Source: Standard Chartered, NAAIM; YCharts Inc. Note: The sector select SPDR ETFs are used to represent sectors

To recap a volatility indicator-linked sector strategy:

- **Sector rotation entails shifting investments between sectors**; this requires a thorough understanding of how different sectors perform across market cycles.
- **Use VIX as a guide**; high VIX levels signal opportunities in cyclical sectors and lower numbers favour defensive sectors. It is important to read these in conjunction with macroeconomic markers such as GDP, inflation and interest rates.
- **Review and adjust sector allocations periodically** to align with evolving market trends and changing economic conditions.
- **Diversify across sectors and market cap**s to avoid extreme risk exposures. Investing via sector ETFs and mutual funds can be an easy way to pivot sector allocations efficiently while staying diversified.

While such a strategy can go a long way in helping mitigate against broad market drawdowns, investment portfolios can still be susceptible to market drawdowns despite best efforts from this strategy to insulate them. This is where having a structured approach to navigating market turbulence is key to long-term wealth preservation.

Stick to a structured approach

Volatility in the stock markets is normal. Having a structured approach to plan for and tackle this can help one to stay the course and generate optimal risk-adjusted returns.

Have some liquidity

Statistically, portfolios that hold cash often generate sub-optimal returns compared to ones that are fully invested. However, having some liquidity can help in managing margin calls or emergencies without being forced to sell your holdings when markets fall. This will also enable one to capitalise on opportunities that may emerge during a market slump.

Diversify the portfolio

Studies indicate that concentrated portfolios have lower Sharpe ratios (return per unit of risk) than more diversified ones. Strategic asset allocation (i.e.. A portfolio strategy that sets target allocations across asset classes and rebalances periodically) and diversifying within each asset class are critical to mitigate risks and optimise returns. Investors can consider both sector-wise and geography-wise diversification. Meaningful diversification is achieved if stocks, sectors or asset classes with low or negative correlation to each other are added to a portfolio.

Stick to your risk tolerance level

Portfolio construction and realignments should be made after due consideration of one's personal risk appetite. If exposure to a particular asset class or underlying constituent exceeds one's tolerance limit due to the magnitude of its volatility and market fluctuations become overwhelming, it is prudent to reduce risk in a systematic manner rather than making knee-jerk changes to portfolios and incurring losses.

Embrace a long-term perspective

With a long-term approach, an investor is not compelled to address temporary market fluctuations. This approach helps ensure investment decisions are more data-driven, less biased and less emotional. A long-term orientation also helps in harnessing the benefits of compounding returns, maintaining stability against market fluctuations, and achieving cost and tax efficiency.

Continue to invest and stay invested

By investing a fixed sum of money regularly, investors can benefit from dollar cost averaging over time. This technique enables smoothening of purchase costs and promotes a disciplined investing approach. Investments made during market drawdowns could even generate outsized returns.

Capitalise on opportunities

Market corrections often present opportunities in the form of undervalued stocks or sectors. Investing in companies that are trading below their intrinsic value can generate outsized returns. However, focusing on quality investments with impeccable fundamentals is key.

Conclusion

Volatility can no doubt be distressing. As a long-term investor, it is essential to stay focused on fundamentals and capitalise on opportunities that emerge during such turbulent times. Following a structured strategy can help keep emotions and behavioural biases in check, ensuring investment strategies stay on course.

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